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Supreme Court, U.S.
FILED
FEB 6 - 2008
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30pgs (37) (38)

Nos. 06-1457 and 06-1462

In the Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC.,
PETITIONER

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL., PETITIONERS

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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REPLY BRIEF FOR THE
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The Federal Energy Regulatory Commission (Commission or FERC) reasonably interpreted the Federal Power Act (FPA), 16 U.S.C. 791a *et seq.*, to limit a party's right to avoid the terms of its own voluntarily undertaken contract. In refusing to defer to FERC's construction of the statute, and in setting aside FERC's

decision in these cases, the Ninth Circuit effectively overturned decades of case law flowing from this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (*Mobile*), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*). Its decision should be reversed.

Respondents contend that the Commission's orders disregarded the FPA's requirement that rates be "just and reasonable," 16 U.S.C. 824d(a). That is incorrect. In fact, FERC applied the statutory standard, recognizing that, in the context of rates set by contract, a just and reasonable rate is one that is not inconsistent with the public interest. That standard recognizes the central importance of the stability and reliability of long-term contracts, which benefit purchasers (and ultimate consumers) as well as sellers by enabling them to allocate and control the risk of market volatility. Contrary to the view of respondents and the court of appeals, the Commission was not required to determine that various newly devised "prerequisites" were satisfied before it could apply the public interest standard of *Mobile* and *Sierra*.

Respondents also challenge the Commission's application of the public interest standard. They suggest that in assessing whether the challenged contracts were just and reasonable under *Mobile* and *Sierra*, the Commission disregarded evidence of dysfunctions in the spot market at the time the challenged forward contracts were consummated. The Commission did not disregard such evidence, but considered it—along with all of the other evidence pertaining to the challenged contracts—in determining that the buyers had not shown that the contracts were contrary to the public interest. Respondents disagree with the Commission's conclusions, but

their disagreement rests largely on their criticisms of the Commission's factual findings, and those findings must be upheld because they are supported by substantial evidence.

A. The Commission Reasonably Interpreted The Federal Power Act To Provide For Limited "Public Interest" Review Of Proposed Changes To Rates Set By Contract

Respondents assert (Snohomish Br. 28; Golden State Br. 29-30; California Br. 58-59) that FERC misinterpreted the FPA in concluding that a "public interest" standard applies when a party to a contract challenges the rates set by that contract as unjust and unreasonable. According to respondents, the statutory requirement that rates be "just and reasonable," 16 U.S.C. 824d(a), applies in the same manner to every instance in which the Commission reviews rates. In their view, by applying the public interest standard recognized in *Mobile* and *Sierra*, the Commission "refused to apply the just and reasonable standard" (Snohomish Br. 30) and indeed "expressly repudiated" that standard (Golden State Br. 31). Respondents misconstrue the FPA, this Court's decisions in *Mobile* and *Sierra*, and the Commission's orders. As explained in FERC's opening brief (at 19-25), the Commission's application of the public interest standard in this case represents a reasonable interpretation of the statute that is entitled to deference under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984), and should be upheld.

1. The premise of respondents' argument is that the public interest standard recognized in *Mobile* and *Sierra* and applied by the Commission here is somehow inconsistent with the "just and reasonable" standard of Section 824d. That premise is erroneous. The public

interest standard is not a different standard; it is simply an application of the general just and reasonable standard in the context of rates previously set by contract.

Respondents fail to recognize the ambiguity in Section 824d's mandate that rates be "just and reasonable." In their view (California Br. 60), the statute is unambiguous, and FERC's orders were "contrary to the plain language * * * of the FPA." Tellingly, respondents do not specify what sort of just-and-reasonableness review they think the statute "unambiguously" (Snohomish Br. 29) requires. Nor could they plausibly do so, since, as this Court has recognized, the Commission is not "bound to the use of any single formula" in applying the just and reasonable standard. *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (*Hope Natural Gas*); see *Global Crossing Telecomms., Inc.* v. *Metrophones Telecomms., Inc.*, 127 S. Ct. 1513, 1521-1522 (2007) (identifying ambiguity in the Communications Act's prohibition of "unjust or unreasonable" practices). Under the FPA, FERC has broad discretion to determine the precise standard of review that it will use in carrying out the statutory directive that rates be just and reasonable.

This Court's decisions in *Mobile* and *Sierra* demonstrate that the just and reasonable standard does not impose strict rate-of-return regulation on all rates, as respondents seem to assume. Instead, *Mobile* and *Sierra* make clear that the public interest standard is an appropriate framework for assessing the justness and reasonableness of contractually set rates in cases where, as here, the contracting parties have not preserved their ability to make unilateral changes to the contract. Cf. *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958) (*Memphis*). *Mobile* and *Sierra* rest upon a recognition that the FPA—like the

materially identical Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*—permits parties to set rates by contract. *Mobile*, 350 U.S. at 338; *Sierra*, 350 U.S. at 353. Likewise, they reflect the commonsense notion that rates negotiated in arms-length transactions are very likely to be just and reasonable, and that the public interest standard allows FERC to eliminate any outliers. Moreover, the FPA and the NGA do not alter the background legal principle that contracting parties are bound by their contracts and are not at liberty to change their terms unilaterally. *Mobile*, 350 U.S. at 343. See *Maine Public Utils. Comm'n* v. *FERC*, 454 F.3d 278, 283 (D.C. Cir. 2006) ("*Mobile-Sierra*'s recognized purpose [is] ensuring contract stability by 'subordinat[ing] the statutory filing mechanism to the broad and familiar dictates of contract law.'") (quoting *Borough of Lansdale* v. *FPC*, 494 F.2d 1104, 1113 (D.C. Cir. 1974)).

Thus, if parties choose to specify rates by contract, without preserving the right to make unilateral changes under *Memphis*, they may not be relieved of their contracts simply because the rates become disadvantageous to their private interests. Relief is available only "when their interests coincide with the public interest." *Mobile*, 350 U.S. at 344; see *id.* at 339 ("[T]he Natural Gas Act permits the relations between the parties to be established initially by contract, the protection of the public interest being afforded by supervision of the individual contracts."); *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968) (*Permian Basin*) ("The regulatory system created by the Act is premised on contractual agreements voluntarily devised by the regulated companies; it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity."). In other words, a party seeking to change a rate to

which it previously agreed by contract carries its burden of showing that the rate is unjust and unreasonable only by demonstrating that it is contrary to the public interest.

2. Respondents nevertheless contend (Snohomish Br. 30) that FERC "refused to apply the just and reasonable standard" and instead "applied a different standard." Respondents misread FERC's orders. To be sure, at various places in its orders, the Commission employed language that in isolation might be read to suggest that the public interest standard is distinct from the just and reasonable standard. For example, FERC stated at one point that certain evidence "would be relevant to contract modification only where there is a 'just and reasonable' standard of review," and that "the contracts at issue in this proceeding do not provide for such a standard but rather evidence an intent that the contracts may be changed only pursuant to the 'public interest' standard." J.A. 1275a; see J.A. 1567a. In context, however, it is apparent that the Commission used the phrase "'just and reasonable' standard of review" as a kind of shorthand to refer to the just and reasonable standard as it has traditionally been applied—using cost-based principles—in ordinary cases that do not involve a contract or *Mobile* and *Sierra* principles. While the use of a modifier such as "ordinary" would have eliminated any potential confusion, that omission is hardly fatal. Although on this point the Commission's phrasing may have been "of less than ideal clarity," its "path may reasonably be discerned." *Bowman Transp., Inc.* v. *Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 286 (1974); see *Shepard* v. *NLRB*, 459 U.S. 344, 350 (1983) (upholding an NLRB decision that was "something less than a model of expository prose," where "the

sense of the Board's explanation" was adequate); *Permian Basin*, 390 U.S. at 818 & n.106 (concluding that "despite certain infelicities of [the Commission's] opinion," "on fair reading its intentions seem entirely clear" regarding the application of the just and reasonable standard to natural-gas rates).

Certainly nowhere in its orders did FERC say that it intended to ignore the test prescribed in the FPA—which the Commission cited several times, see, *e.g.*, J.A. 1226a, 1235a-1236a, 1245a—and replace it with a different test. Moreover, FERC emphasized that a "finding that changes to the challenged contracts should be evaluated under the public interest standard does *not* equate to a finding that the underlying rates are not just and reasonable." J.A. 1567a (emphasis added). This Court should not presume that the Commission disregarded the statute without saying so. Cf. *USPS* v. *Gregory*, 534 U.S. 1, 10 (2004) (presumption of regularity attaches to the actions of government agencies).

The Commission's shorthand description is not materially different from the formulation employed by several courts of appeals. The First Circuit, for example, has described the public interest standard as "a more difficult standard for the Commission to meet than the statutory 'unjust and unreasonable' standard of [16 U.S.C. 824e]." *Northeast Utils. Serv. Co.* v. *FERC*, 993 F.2d 937, 960 (1993) (*Northeast Utils. I*). Similarly, the District of Columbia Circuit has held that "[t]he public interest standard of the *Mobile-Sierra* doctrine is much more restrictive than the just and reasonable standard of [Section 824d]." *Atlantic City Elec. Co.* v. *FERC*, 295 F.3d 1, 14 (2002) (*Atlantic City*); accord *Potomac Elec. Power Co.* v. *FERC*, 210 F.3d 403, 407 (D.C. Cir. 2000) (*PEPCO*) ("[T]he *Mobile-Sierra* public interest standard

is much more restrictive than the FPA's 'just and reasonable' standard."). Like the Commission, the First and District of Columbia Circuits could have eliminated any potential for confusion by adding the modifier "ordinary" before "just and reasonable," but that omission does not betray any deviation from the statute or any suggestion that this Court in *Mobile* and *Sierra* had adopted a standard of review inconsistent with the statute.

3. Respondents contend (Snohomish Br. 31) that the Commission's interpretation of the FPA as calling for the public interest standard of review in this setting is not entitled to deference under *Chevron* because the Commission did not recognize that it had discretion. Contrary to respondents' assumption, there is no requirement that an agency expressly acknowledge statutory ambiguity in order to receive *Chevron* deference in interpreting a statute—the two-step analysis of *Chevron* is a methodology for reviewing courts, not a rule of administrative drafting. In any event, the Commission in this case did not disclaim the existence of discretion in an effort "to avoid responsibility for its own policy choice." *Baltimore & Ohio R.R.* v. *ICC*, 826 F.2d 1125, 1129 (D.C. Cir. 1987). To the contrary, it recognized the policymaking responsibility imposed upon it by Congress in the ambiguous language of the FPA, and it explained why it had determined that application of the public interest standard was appropriate: "This order," it said, "balances effective rate regulation with respect for the sanctity of contracts." J.A. 1229a; see J.A. 1245a (explaining that the public interest standard is applicable to market-based rate contracts because "if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate au-

thority, it would make the original grant of market-based rate authority (i.e., the original acceptance of the market-based rate tariff) a pointless exercise of no value to anyone"). While FERC also described the public interest standard as "dictated by the U.S. Supreme Court under the *Mobile-Sierra* doctrine," J.A. 1229a, it can hardly be faulted for emphasizing, in its orders, that its interpretation of the FPA was consistent with that adopted by this Court.

B. The Court Of Appeals Erred In Imposing "Prerequisites" For The Application Of The *Mobile-Sierra* Public Interest Test

The court of appeals held that the modern regime of market-based rates made it appropriate to "modif[y]" the *Mobile-Sierra* standard. Pet. App. 66a. Specifically, the court imposed three "prerequisites" to the application of that standard: (1) the contract must not preclude *Mobile-Sierra* review; (2) FERC must have an opportunity for effective, timely review of the contracted rates; and (3) FERC's review must permit consideration of all factors relevant to the propriety of the contract's formation. *Id.* at 10a. As discussed in FERC's opening brief (at 26), the first prerequisite does not represent a modification of *Mobile* and *Sierra*, because contracting parties have always been able to opt out of *Mobile-Sierra* protections. See *Memphis*, 358 U.S. at 112. Here, although *Memphis* would have permitted the parties to address the possibility of market fluctuations by preserving their right to bring a unilateral challenge to their contract rates, they instead decided to subject their contracts to *Mobile-Sierra* public interest review. Pet. App. 46a.

The court of appeals' latter two prerequisites did far more than "modify" the *Mobile-Sierra* doctrine, cf. *MCI Telecommunications Corp.* v. *AT&T*, 512 U.S. 218, 225-228 (1994) (*MCI*), and respondents' efforts to defend its holding are unavailing. Nothing in the FPA or this Court's decisions in *Mobile* and *Sierra* compels the two prerequisites the court advanced, and the court of appeals had no basis for substituting its judgment for that of the Commission—or this Court—on whether the application of the public interest standard is an appropriate way to implement the FPA.

1. As explained in FERC's opening brief (at 33-34), although the contracts in *Mobile* and *Sierra* had been filed with the Commission, the Commission made clear in its orders that it had not undertaken any substantive review of the contracts. Thus, this Court's decisions in those cases did not rest on the assumption that FERC had examined the rates in the contracts and found them to be reasonable. Respondents point out (Snohomish Br. 42 n.27) that the Commission in *Mobile* and *Sierra* "had the *opportunity* to review the contracts in the first instance," but nothing in *Mobile* or *Sierra* suggests that that fact was significant. Nor is there any reason why the existence of an unseized opportunity to review the rates should have mattered to the Court's analysis. See *United Gas Pipe Line Co.*, 5 F.P.C. 770 (1946); *Pacific Gas & Elec. Co.*, 7 F.P.C. 832 (1948) (making clear that the Commission did not exercise its opportunity).

The adoption of a market-based rate regime does not require any change in the scope of *Mobile* and *Sierra*. Given that a market-based rate regime is a permissible way for FERC to discharge its duty to ensure just and reasonable rates, see Pet. App. 47a; *California ex rel. Lockyer* v. *FERC*, 383 F.3d 1006, 1017 (9th Cir. 2004),

cert. denied, 127 S. Ct. 2972 (2007)—a conclusion not challenged in this case, see Snohomish Br. in Opp. 26—there is no reason why *Mobile* and *Sierra* should apply only in some far more constricted or watered-down way to contracts entered into under that regime. To the contrary, because a market-based regime depends critically on private contracts to function, the protection afforded the validity and enforceability of contracts under *Mobile* and *Sierra* is especially important in this context.

Respondents suggest (California Br. 46) that "opportunity for review of the application of a rate in practice" is required by this Court's decisions in *Maislin Industries U.S., Inc.* v. *Primary Steel, Inc.*, 497 U.S. 116 (1990) (*Maislin*), and *MCI*. That argument has little to do with the application of *Mobile* and *Sierra*, but rather is essentially an attack on market-based rates in general. But respondents have not challenged FERC's institution of market-based rates (or the authorization for petitioners to sell power at market-based rates), and the lawfulness of both should be taken as a given here. In any event, respondents' theory lacks merit because the Commission's interconnected program of *ex ante* findings of no market power, coupled with post-approval reporting requirements, distinguishes the market-based rate program from those at issue in *Maislin* and *MCI*.

Maislin involved an ICC policy that allowed carriers to charge privately negotiated contract rates that differed from the filed tariff rate, that were never disclosed to or reviewed by the ICC, and that were not subject to any challenge for discrimination. 497 U.S. at 132-133. This Court found that the policy violated the filed-rate doctrine. See *id.* at 127. Here, in contrast, market-based sales are made in accordance with a market-based rate umbrella tariff, which is approved only after FERC

determines, in a publicly-noticed proceeding with opportunity for interested parties to protest, that a seller lacks or has adequately mitigated market power. See *Lockyer*, 383 F.3d at 1009. As noted, after market-based rate authority is granted, parties can file complaints, or FERC can institute its own proceeding, to challenge market-based rates as unduly discriminatory or unjust or unreasonable, or to question whether the seller has market power.

Respondents' reliance on *MCI* is similarly misplaced. *MCI* rejected an FCC policy that relieved *all* nondominant carriers of *any* requirement to file any of their rates with the agency. This Court held that such wholesale detariffing for nondominant carriers effectively removed all rate regulation wherever the FCC found competition to exist, in violation of specific language in the Communications Act of 1934, 47 U.S.C. 151 *et seq.* *MCI*, 512 U.S. at 224-225, 231-232. FERC's market-based rate system, by contrast, requires every seller with market-based rate authority to have on file an umbrella market-rate tariff and to file quarterly reports detailing the specific rates charged for each sale. See *Lockyer*, 383 F.3d at 1013. No detariffing occurs in these circumstances. As the *MCI* Court held, it would not violate the filed-rate doctrine for the FCC to "modify the form, contents, and location of required filings, and [to] defer filing or perhaps even waive it altogether in limited circumstances." 512 U.S. at 234. That is precisely what FERC did here.

Contrary to respondents' theory, *Mobile* and *Sierra* are not based on a mere rebuttable "presumption," Pet. App. 38a, that rates set by contract are lawful because they approximate what the Commission would deem just and reasonable in a regulatory proceeding. See Snoho-

mish Br. 35-37; Golden State Br. 44-45. Instead, they rest on a recognition that, under the FPA, "rates to particular customers may be set by individual contracts," *Mobile*, 350 U.S. at 338; see *Sierra*, 350 U.S. at 353, that rates negotiated in arms-length transactions are likely to be just and reasonable, and on the fundamental principle that contracting parties are bound by the terms of their contracts, which can be varied only when necessary to effectuate the public interest, as opposed to the private interests of the parties, see *Mobile*, 350 U.S. at 344; *Sierra*, 350 U.S. at 355 ("[As] the purpose of the power given the Commission by [the FPA] is the protection of the public interest, as distinguished from the private interests of the utilities," it is "clear that a contract may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility."). The change in regulatory context to market-based rates does not—and could not—alter the statutory authorization for rates to be set by contract, subject to FERC's overriding authority to alter such rates when they are contrary to the public interest. See *Mobile*, 350 U.S. at 338.

Respondents' arguments about the need for ongoing market oversight as a precondition for the application of the public interest standard rest on the erroneous premise that FERC's oversight must continually ensure that market-based rates bear some relationship (apparently) to a *post hoc* determination of costs plus a rate of return. See Snohomish Br. 36, 42-43; California Br. 45-46; Golden State Br. 46. Although the Commission maintains oversight over the markets in an effort to ensure that they are functioning properly, no initial review—whether of cost-based rates or market-based rates—could guarantee that approved rates will be just and reasonable (in the sense of being tied to cost) under all

subsequent circumstances. Rather, in both situations, the initial review rests on a factual determination tied to then-existing circumstances that may change over time. When the circumstances that gave rise to the initial rate approval have allegedly changed, Section 824e specifies procedures for altering the rates authorized under either a cost-based or market-based rate regime. In this case, for example, respondents could have availed themselves of those procedures to challenge FERC's grant of market-based rate authorization, and, if dissatisfied with the Commission's resolution of their challenge (California Br. 56), could have sought judicial review, see 16 U.S.C. 825*l*. Alternatively, they could have invoked *Memphis* to preserve their rights to modify the contract in the future. But where, as here, contracting parties do not take those steps, then their contract is subject to the *Mobile-Sierra* standard of review, and the Commission appropriately applies the *Mobile-Sierra* public interest standard in considering whether to modify it.

That is not to say that the Commission can or should turn a blind eye to the functioning of the market. See FERC Br. 31-32 (detailing statutory amendments and Commission actions subsequent to the events at issue in this case that enhance the Commission's ability to monitor markets and prosecute manipulation). But nothing in *Mobile* or *Sierra*, or in the FPA, suggests that an alleged deficiency in the Commission's oversight can justify the abrogation of contracts that are not contrary to the public interest. Contracts are entered into by both parties in the context of the existing regulatory regime, and the parties are entitled to assume the validity of that regime insofar as the validity of their private contracts is concerned. Deficiencies in FERC's oversight or other aspects of the regulatory regime should be ad-

dressed directly and prospectively, as both Congress and FERC have done. Respondents' criticisms of the Commission's market oversight during 2000-2001 (Snohomish Br. 42-43; California Br. 44, 51-54; Golden State Br. 45-47) are therefore not relevant to the enforceability of the contracts here.

2. Respondents' efforts to justify the court of appeals' imposition of a second prerequisite—"a determination that the challenged contract was initially formed free from the influence of improper factors," Pet. App. 57a—fare no better. Contrary to respondents' assertion, the Commission did not "ignore[]" evidence of market dysfunction (Snohomish Br. 39), nor did it deem such evidence to be "irrelevant" (California Br. 18). Instead, the Commission concluded that any evidence of market dysfunction should be considered along with the totality of the circumstances involving each challenged contract in determining whether the contract was contrary to the public interest. See, *e.g.*, J.A. 1274a. The court of appeals erred in rejecting that determination and holding that consideration of the circumstances of contracting was a necessary prerequisite to application of the *Mobile-Sierra* public interest test in the first instance. Pet. App. 41a.

Like the court of appeals, Pet. App. 41a, Golden State (Br. 51-52) claims to find support in *Atlantic City*, 295 F.3d at 14, which stated that *Mobile-Sierra* applies "assuming that there was no reason to question what transpired at the contract formation stage." Of course, under general principles of contract law, circumstances such as duress or mutual mistake in contract formation may prevent the formation of a valid contract. See *Public Util. Dist. No. 1 v. IDACORP, Inc.*, 379 F.3d 641, 648, 652 n.13 (9th Cir. 2004). There is no dispute that if

a contract is void *ab initio* as a result of such circumstances, then the *Mobile-Sierra* doctrine is inapplicable, as there is no proper contract to preserve. See *ibid.*; see also, *e.g.*, *Town of Norwood* v. *FERC*, 587 F.2d 1306, 1309-1310, 1313 (D.C. Cir. 1978) (*Norwood*) (remanding orders applying *Mobile-Sierra* where questions arose regarding parties' "fairness and good faith" at contract formation); *PEPCO*, 210 F.3d at 410 (*Mobile-Sierra* applies absent evidence of "unfairness or bad faith" in the original contract negotiations).

Here, however, the Commission found—and the court of appeals acknowledged—that there was no evidence calling into question the good faith of all parties in the negotiations for the challenged contracts. See Pet. App. 301a (finding "no evidence of unfairness, bad faith, or duress in the original negotiations"); J.A. 1285a. As the court of appeals observed, "the local utilities do not allege that the energy companies manipulated their negotiations of the contracts here at issue; the local utilities challenge the *context*, not the conduct of those negotiations." Pet. App. 59a. In the absence of any evidence that the contracts were not validly formed, allegations regarding the "context" of the negotiations are not a basis for refusing to apply *Mobile-Sierra*. "[A]bsent any claim, much less evidence, of unfairness or bad faith in the original negotiations, it is reasonable for FERC to require parties 'to live with their bargains as time passes and various projections about the future are proved correct or incorrect.'" *PEPCO*, 210 F.3d at 410 (quoting *Norwood*, 587 F.2d at 1312).

Respondents fault the Commission for focusing on the individual contracts at issue (Snohomish Br. 46-47; California Br. 50), but it has long been the norm in applying *Mobile-Sierra* to focus on the challenged contract

and its particular impact on the public interest. "[T]he public interest necessary to override a private contract * * * requires analysis of the manner in which the contract harms the public interest and of the extent to which abrogation or reformation mitigates the contract's deleterious effect." *Texaco Inc.* v. *FERC*, 148 F.3d 1091, 1097 (D.C. Cir. 1998). See, *e.g.*, *Atlantic City*, 295 F.3d at 14 (reversing FERC orders modifying contract for failure to make a particularized finding that the public interest required modification of the individual contract at issue).

The court of appeals therefore erred in holding that the Commission was required to evaluate the general dysfunction in the California spot markets before it could apply *Mobile-Sierra* to the challenged contracts and examine all of the circumstances bearing on the public interest. Under *Mobile-Sierra* and its progeny, the Commission reasonably determined that, even if allegations that the spot market dysfunctions generally had an effect on forward contracts were accepted as true, that alone would not answer the question whether the challenged contracts were contrary to the public interest. Pet. App. 292a.

Under respondents' theory, contracting parties would be free to avoid the contract rates they agreed to pay—even after having also agreed to the application of the *Mobile-Sierra* doctrine—based solely on a *post hoc* determination, perhaps several years later, that the market lacked competition sufficient to produce what FERC would have found to be just and reasonable rates in the first instance, presumably using a cost-based methodology. See Snohomish Br. 36; California Br. 27. That standard would essentially prevent parties from entering into long-term contracts, despite the obvious

advantages such contracts provide. Respondents claim that their test would not allow reopening of all rates, but only those subject to circumstances "beyond ordinary supply-demand dynamics," (Snohomish Br. 58). That standard is so vague, however, that it would provide little guidance to the Commission. Worse, it would make it difficult—if not impossible—for parties to determine at the time of contracting whether their contracts would be secure under the protection afforded by *Mobile-Sierra*. The Commission would be required to modify contracts based on an array of factors or conditions that might have affected the marketplace at or around the time of contract formation, but that may have only an attenuated relation to the relative fairness of the contract in the market and regulatory context in which it was formed. And because competition in practice seldom conforms to textbook theory, there would be a substantial incentive for many parties who came to regret a deliberate contracting decision to invoke FERC's jurisdiction to overturn the deal—if only to obtain a settlement from the other party.

Long-term contracts are a means by which *both* contracting parties can allocate and control the risk of short-term market volatility. See *San Diego Gas & Elec. Co.* v. *FERC*, 904 F.2d 727, 730 (D.C. Cir. 1990) (*San Diego*). But under respondents' theory, it is precisely in times of volatility, when long-term contracts are most valuable, that such contracts would be most subject to challenge by whichever party turns out to be disappointed by subsequent events. That would defeat the purpose of the *Mobile-Sierra* doctrine, which is to promote contract stability by precluding contracting parties from unilaterally seeking to change their contracts even though there was no fraud, duress, or mis-

take during the contracting process. See *Mobile*, 350 U.S. at 344.

C. The Commission Reasonably Applied The Public Interest Standard To Uphold The Challenged Contracts

Respondents contend that FERC improperly applied the public interest standard of *Mobile* and *Sierra*. Many of their arguments rest on the theory that the public interest standard is fundamentally asymmetrical, that is, that it makes it far easier for purchasers to challenge high rates than for sellers to challenge low rates. In addition, they take issue with the Commission's factual findings about the contracts at issue here and about the operation of the electricity markets more generally. Neither of those claims withstands scrutiny.

1. Like the court of appeals, Pet. App. 62a, 66a, respondents contend (Snohomish Br. 34-35) that the "excessive burden" standard announced in *Sierra* is applicable only in a "low-rate" case where a seller seeks a rate increase. In a "high-rate" case, where the buyer seeks a rate decrease, they suggest that the appropriate standard is whether customer's electric bills were "higher than they otherwise would have been had the challenged contracts called for rates within the just and reasonable range." Pet. App. 64a. Whether or not that approach might have been permissible, FERC was not required to adopt it.

The Commission has considerable discretion in determining when the public interest calls for abrogation of a private contract, and respondents have not shown that it acted unreasonably here. *Mobile* and *Sierra* make clear that whether a contractually specified rate "adversely affect[s] the public interest" and therefore may be deemed unjust and unreasonable is "a question

to be determined in the first instance by the Commission." *Sierra*, 350 U.S. at 355; see *Northeast Utils. Serv. Co.* v. *FERC*, 55 F.3d 686, 690 (1st Cir. 1995) (*Northeast Utils. II*) ("[N]owhere in [*Mobile*] is the term 'public interest' defined," and, "[i]ndeed, the Court seems to assume that the Commission decides what circumstances give rise to the public interest."); *Metropolitan Edison Co.* v. *FERC*, 595 F.2d 851, 859 (D.C. Cir. 1979) (determination of the public interest is reserved to FERC's discretion). The Commission has interpreted that standard, consistently with numerous decisions of this Court and the courts of appeals, to be a demanding one for sellers and buyers alike.

According to respondents (California Br. 31 n.19), this Court held in *Permian Basin* that the public interest standard applies asymmetrically. Respondents misread that decision. In *Permian Basin*, the Court emphasized that "the Commission was here without authority to abrogate existing contracts unless it first concluded that they 'adversely affect the public interest.'" 390 U.S. at 821 (quoting *Sierra*, 350 U.S. at 355). Although the Court upheld the Commission's decision to set aside some of the contracts at issue in that case, it did so on the basis of the *Commission's finding* that the prices in those contracts did affect the public interest, and it concluded that there was no reason "to set aside the Commission's judgment." *Ibid.*; see *id.* at 783-784. *Permian Basin* demonstrates the breadth of the Commission's discretion in applying the public interest standard; it does not force FERC to apply the standard differently depending on which party to a contract is seeking to alter the agreed-upon rates.

Respondents also assert (California Br. 30-32) that it is appropriate that *Mobile-Sierra* protections be

asymmetrical, as the Commission is required to provide only the "constitutional minimum" rate of return to protect sellers from confiscatory rates but must protect consumers from any rates that exceed the zone of "reasonableness." The Commission's role under the FPA is not so one-sided. Rather, the Commission is called upon to "balanc[e] . . . the investor and consumer interests." *Permian Basin*, 390 U.S. at 776 (quoting *Hope Natural Gas*, 320 U.S. at 603). The FPA's "core purpose" is not only preventing "excessive rates," but also facilitating the "orderly development of plentiful supplies of electricity," and protecting against inadequate service. *Consolidated Edison of N.Y., Inc.* v. *FERC*, 510 F.3d 333, 342 (D.C. Cir. 2007) (quoting *Public Utils. Comm'n* v. *FERC*, 367 F.3d 925, 929 (D.C. Cir. 2004)). In the long run, protecting the stability of supply arrangements benefits buyers as well as sellers. *Mobile*, 350 U.S. at 344. Moreover, long-term supply contracts today permit contracting parties to allocate and protect against the risk of short-term market volatility. *San Diego*, 904 F.2d at 730.

Thus, "[e]xcept as the exigencies of the public interest demand[]," FERC is "no more at liberty to alter the * * * contract to the prejudice of the [sellers] than to do so in their favor." *Public Serv. Comm'n* v. *FPC*, 543 F.2d 757, 798 (D.C. Cir. 1974). As discussed in the Commission's opening brief (at 40), the Commission properly concluded that the same public interest standard protects both buyers and sellers in high and low rate cases. See *PEPCO*, 210 F.3d at 406, 410 (applying *Sierra* public interest factors in a case where rates were allegedly too high); *Northeast Utils. I*, 993 F.2d at 961 (holding, in a case alleging that contract rates were harmful to third parties, that the effect of the public interest standard,

"as formulated by the Supreme Court, is the protection of outside parties from 'undu[e] discriminat[ion]' or imposition of an 'excessive burden.'") (quoting *Sierra*, 350 U.S. at 355); *Northeast Utils. II*, 55 F.3d at 691 (same); see also *Papago Tribal Util. Auth.* v. *FERC*, 723 F.2d 950, 953 n.4 (D.C. Cir. 1983) (Scalia, J.) ("Discrimination or preference that operates against the contracting purchaser can presumably be waived—just like unreasonableness—up to the point where it produces some independent harm to the public interest.").

2. Respondents contend that the public interest did favor contract reformation in this case, but their arguments rest on an impermissible second-guessing of the Commission's factual findings. Those findings are reviewed under the substantial evidence standard, see 16 U.S.C. 825*l*(b), and they may be set aside only if a "reasonable factfinder would have to conclude" that the agency erred. *INS* v. *Elias-Zacarias*, 502 U.S. 478, 481 (1992). Respondents have not come close to meeting that standard.

According to respondents (Snohomish Br. 37-39), the purchasers lacked a choice of suppliers, and as a result the contracts at issue were unjust and unreasonable when they were signed. Those assertions are not supported by the evidence in the record. For example, the evidence showed that the respondents Nevada Power Co. and Sierra Pacific Power Co. purchased wholesale power from dozens of different providers, while respondent Southern California Water Co. received three different responses to its request for proposals for a long-term contract. J.A. 1282a-1283a. Before it signed its contract, Snohomish received bids from five different suppliers, J.A. 1282a, and the record shows that it engaged in protracted negotiations with Morgan Stanley,

demonstrating that it hardly had "no options" (Snohomish Br. 37) other than to accept the contract it was offered. In any event, under a system of market-based rates, it is to be anticipated that there will be occasions when supply or demand is short. Accordingly, the validity and enforceability of a long-term contract such as those at issue here cannot depend on the range of options the particular buyer or seller had at the moment of contract formation.

Likewise, the claim that the contracts were unreasonable when they were signed cannot be reconciled with Snohomish's statements at the time. In a newsletter distributed to its customers in early 2001, Snohomish explained that the prices in its long-term contracts were "well under the forward market prices predicted for the third and fourth quarters of this year, as well as those forecast for next year," and that the contracts provided "a lot of security against the uncertainty of market fluctuations," allowing Snohomish to "emerg[e] from the power crunch in strong financial condition." FERC Dkt. No. EL02-28-000, Exh. MSC-83, at 6. Snohomish gave no indication that it "could not get what it wanted" and "had to accept the bad deal" it now claims to have negotiated. Snohomish Br. 38.

More broadly, respondents take issue with the Commission's conclusion that the modification of contracts would impair the functioning of the electricity markets. According to respondents (Snohomish Br. 56), various academic economists have opined that setting aside these contracts would actually "improve market functioning." Other economists disagree. See, *e.g.*, Baumol Amicus Br. 21-25. It is not necessary for this Court to resolve the issue, however, because "[w]hen specialists express conflicting views, an agency must have discre-

tion to rely on the reasonable opinions of its own qualified experts even if, as an original matter, a court might find contrary views more persuasive." *Marsh* v. *Oregon Natural Res. Council*, 490 U.S. 360, 378 (1989).

In this case, the Commission determined that "contract modification will harm credit and investor confidence by altering the perception of a formerly stable cash flow into an undependable, risky cash flow" and by reducing the willingness of investors "to invest in merchant energy contracts, which, in turn, could have an adverse effect on infrastructure development, especially at a time when Western markets need new generation and transmission." J.A. 1260a-1261a; see *PacifiCorp*, 99 F.E.R.C. ¶ 61,381, at 62,614 (2002) ("Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are *extraordinary* circumstances."). Those are precisely the kinds of "predictive judgments about areas that are within the agency's field of discretion and expertise" that "are entitled to 'particularly deferential' review" under *Marsh*. *In re Core Commc'ns, Inc.*, 455 F.3d 267, 282 (D.C. Cir. 2006) (quoting *Milk Indus. Found.* v. *Glickman*, 132 F.3d 1467, 1478 (D.C. Cir. 1998)).

The Commission also took account of the fact that the sellers under these contracts were themselves purchasers of power in the same market and in the same price range to cover their contracts here. See J.A. 1261a. Moreover, attempting to unravel all of the transactions between the point of generation and the last wholesale purchaser would require "prolonged time and effort" and would be unlikely to produce "in the end, a fair result." *Puget Sound Energy, Inc.*, 103 F.E.R.C. ¶ 61,348,

at 62,369 (2003), petition for review granted in part and denied in part *sub nom. Port of Seattle* v. *FERC*, 499 F.3d 1016 (9th Cir. 2007). Respondents contend (Snohomish Br. 46) that the "record evidence shows otherwise," but to support that claim they cite only the statement of a Snohomish witness who asserted that "[t]he contract modifications sought by Snohomish PUC would be quite easy to formulate and implement." C.A. E.R. 1086. Even if it would be easy to modify *these* contracts, it would be far from easy to unwind all of the contracts between the sellers in this case and the generators of the power. And it would hardly be equitable—or likely to promote the public interest—to offer relief only to the few purchasers who initiated this proceeding.

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For the foregoing reasons and those stated in the opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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Solicitor General

FEBRUARY 2008